

Before the  
Federal Communications Commission  
Washington, D.C. 20554

In the Matter of	)	
	)	
Connect America Fund	)	WC Docket No. 10-90
	)	
A National Broadband Plan for	)	
Our Future	)	GN Docket No. 09-51
	)	
Establishing Just and Reasonable	)	
Rates for Local Exchange Carriers	)	WC Docket No. 07-135
	)	
High-Cost Universal Service	)	
Support	)	WC Docket No. 05-337
	)	
Developing a Unified Intercarrier	)	
Compensation Regime	)	CC Docket No. 01-92
	)	
Federal-State Joint Board on	)	
Universal Service	)	CC Docket No. 96-45
	)	
Lifeline and Link Up	)	WC Docket No. 03-109

REPLY COMMENTS OF  
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May 23, 2011

## **I. INTRODUCTION**

The Maine Office of the Public Advocate (“OPA”) hereby submits these reply comments in response to the Federal Communications Commission’s (“Commission” or “FCC”) Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking, FCC 11-13.

The OPA is uniquely positioned to submit reply comments in this proceeding because, in the course of proceedings here in Maine, the Public Advocate has examined the actual cost of broadband build-out activities and has also proposed broadband build-out plans as part of the case that accepted the acquisition of the former Verizon Maine properties by FairPoint. Moreover, the OPA continues to monitor FairPoint’s investments in broadband facilities in Maine. In addition, during the course of a series of alternative form of regulation proceedings, the OPA investigated the relationship between regulatory regimes, incentives, and company investments in broadband facilities. These relationships are at the heart of this current FCC proceeding.

These reply comments focus on (1) the need to continue to support the provision and maintenance of broadband services in rural areas, rather than limiting the focus of the federal universal service fund only to construction of facilities in unserved areas, (2) the need to establish incentives related to broadband service deployment, (3) the need to recognize that auctions must be organized in a manner that is fair to all potential bidders, (4) the need to understand the relationship between incentives and constraints regarding switch replacement, (5) the need to collect information required for the maintenance and provision of universal service, and (6) the need to maintain carrier-of-last-resort obligations.

## **II. THE NEED TO CONTINUE TO SUPPORT THE PROVISION AND MAINTENANCE OF BROADBAND SERVICES IN RURAL AREAS.**

Current federal universal service mechanisms are designed to support narrow-band voice service. However, at the same time, those mechanisms contribute substantially to the roll-out of broadband services in three important ways: by providing an incentive to invest in modern equipment, by supporting the repayment of loans undertaken to finance the investment in modern equipment, and by maintaining the financial viability of carriers that have invested in broadband capable facilities.

In short, the incentive to invest is tied directly to the rate-of-return regulation principles that have been incorporated into the current federal universal service mechanisms. If a carrier invests, its rate base increases, and its high-cost support increases. Moreover, it is necessary to invest in order to upgrade the capability of the network to provide broadband services.

The unintended consequence of this incentive to invest might be an over-investment, sometimes referred to as a “gold-plating” of the network. The most likely gold-plating strategy appears to be investments in fiber-to-the-home networks. However, the FCC recognizes that while fiber-to-the-home networks may have high initial capital costs, it notes that the life-cycle cost of fiber-to-the-home networks is approximately the same as copper networks. In addition, commenters such as the Nebraska Rural Independent Companies, other Rural Associations, and the state members of the federal-state universal joint board have proposed schemes to limit the incentive to over-invest by placing limits or caps on investment. We agree with the strategy to place limits on investment and urge the FCC to adopt a program that retains the proper incentive of rate-of-return regulation to invest in broadband facilities while, at the same, to adopt a constrained rate-of-return regulatory scheme that constrains the unintended consequence of gold-plating the network.

Our experience in Maine supports this recommendation. In Maine, the rate-of-return carriers, on average, have made broadband service available to more than 90 percent of their customers, while broadband service was available to approximately 65 percent of the customers of the Maine price-cap carrier.

In addition, for the carriers that have obtained loans to enhance service availability and to continue to provide broadband service, it is essential that these carriers continue to receive federal universal support. If the FCC were to adopt its near-term proposal without providing additional long-term support, many of these carriers would face negative earnings and would achieve TIER ratios and EBITDAs that would put their current loans in jeopardy and would prohibit their ability to access capital markets and obtain additional funding. In their comments, the carriers, their consultants, their associations, and the state joint board members have provided the FCC ample evidence supporting the severe results that would be produced by the FCC's near-term proposals.<sup>1</sup>

These likely results do not mean that reform of the federal universal service mechanisms should not occur. What the results mean is that the near-term proposal should not be implemented without simultaneously implementing a long-term solution. Alternatively, the near-term proposals must be altered so that their implementation is consistent not only with a re-orientation of the funds towards the provision of broadband service, but also with the financial viability of the broadband providers.

With regard to the simultaneous implementation of a long-term solution, the state joint board members have provided the FCC with a comprehensive and detailed plan that re-orientes the federal fund, while at the same, providing both support for the financial viability of the

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<sup>1</sup> Comments of Fred Williamson and Associates, Comments of the Rural Associations (NECA et al), Comments of GVNW, Comments of Warinner, Gesinger & Associates, and Comments by State Members of the Federal State Joint Board on Universal Service.

carriers and a transition from existing mechanisms to the new mechanism. The state members' plan starts by allowing the carriers to retain their current funding until such time as new cost studies can be prepared and as long as the carriers can show a need for the support and as long as the carriers are meeting broadband provisioning criteria. However, if the carriers are over-earning and thus do not need the support, the support is reduced. If the carriers are not meeting the broadband provisioning criteria, the support is reduced. In short, the state members' plan focuses on a carrier's financial viability and re-orient's support towards the provision of broadband services. Once the new cost studies have been prepared, the state members' plan increases the focus on the broadband services because support is provided to very low density areas ("donut" areas) based on the cost to build out an enhanced infrastructure that can provide both voice and broadband services. Those donut areas are the areas where large price-cap carriers and cable companies have been reluctant to provide broadband service and where it is necessary to provide universal service funding in order to maintain the provision of broadband service by the rate-of-return rural carriers. We urge the FCC to adopt the state members' plan or a similar plan because that plan will accomplish the goals that the FCC set out in its notice. Moreover, the state members' plan does not impair the current provision of broadband services and therefore, it is superior to the FCC's near-term universal service reform proposals. If the FCC does not choose to adopt the state members' plan or a similar plan, then the FCC should not adopt its near-term proposals. Rather it could place constraints on corporation operations expenses as suggested by the Rural Alliance, or it could adopt the constrained rate-of-return regulation suggested by the Nebraska Rural Carriers. Both of these suggestions are less comprehensive than the state members' plan. What is important is that both of those plans cause

no harm, whereas the adoption of the near-term proposals will significantly impair the current provision of broadband services in rural areas.

### **III. THE NEED TO ESTABLISH INCENTIVES RELATED TO BROADBAND SERVICE DEPLOYMENT.**

Telecommunications carriers are regulated by the FCC under two regulatory regimes, rate-of-return and price-caps. As noted above, rate-of-return regulated carriers have in general extended broadband service to the overwhelming majority of their customers. The customers of price-cap carriers, especially the rural customers of price-cap carriers, do not have the same level of service. In Maine, the price-cap carrier, Verizon, did not provide broadband service in many rural areas. Similar failures to provide ubiquitous broadband service have been noted in the recent merger proceedings in which Frontier purchased selected Verizon service territories and in which Century-Link purchased Qwest.

Price-cap regulation allowed carriers to earn very high profits without investing in general, and without investing in broadband service facilities in particular. According to the theory underlying price-cap regulation, the ability to earn higher profits was supposed to encourage investment. In reality, however, net investment decreased substantially for all major price-cap carriers.<sup>2</sup> These carriers siphoned funds out of wireline industry rather than using the funds to enhance the service capability of the wireline industry. Because of that failure to provide broadband service, we urge the FCC to prohibit the adoption of price-cap regulation by any additional carriers.<sup>3</sup>

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<sup>2</sup> See the ARMIS 43-01 reports comparing net investment for price carriers in 1996 to net investment in 2007. Net investment is not available for later years.

<sup>3</sup> On a technical note, price-cap regulation relies on the ability to measure productivity growth. However, the FCC has not conducted a productivity study for a long time and therefore, it is no longer possible to know what the productivity offset should be. It has been suggested that due to decreases in lines and minutes, industry productivity may be declining. However, the output of the industry is no longer lines and minutes. It now includes data, special access and video services. Because telecommunication industry inputs cannot be separated and linked to individual output, it is necessary to measure productivity using all of its outputs. To our knowledge, productivity studies using

In addition to the general incentives that are incorporated into the two alternative regulatory regimes, we urge to the Commission to adopt specific incentives that tie universal service support to the provision of broadband service. The plan proposed by the state members contains such specific incentives. That plan requires carriers to increase broadband availability over time in order to receive universal service support. The plan also requires carriers to enhance the service quality of the broadband offering. While there may be an alternative set of requirements that are superior to the requirements included in the state members' plan, we urge the Commission to adopt either the state members' broadband requirement provision, or some similar plan that contains incentives that directly link the provision of broadband and universal service support.

#### **IV. THE NEED TO RECOGNIZE THAT AUCTIONS MUST BE ORGANIZED IN A MANNER THAT IS FAIR TO ALL POTENTIAL BIDDERS.**

The FCC proposes to use a reverse auction in order to allocate CAF build-out funds among carriers that bidding for these funds. Under the general rules for that auction, the carrier that provides the lowest bid price per unit receives funding first. Additional funding is provided to the next lowest bidder in succession until all the funds available have been allocated. The FCC suggests that that type of auction is efficient and will maximize the benefits that can be derived from the use of the limited funds.

In their comments, several other parties have discussed the numerous problems associated with the auction system.<sup>4</sup> We wish to build on those comments and our experience in

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all current outputs have not been entered into the record of any case in the United States. For a discussion regarding the inability to measure the productivity related to an individual service in an industry with substantial joint and common costs, see Jeffrey I. Bernstein and David E.M Sappington, "Setting the X Factor in Price Cap Regulation Plans," *Journal of Regulatory Economics*, 16, 1999.

<sup>4</sup> Comments of the Rural Associations and Comments by State Members of the Federal State Joint Board on Universal Service

Maine to show that the FCC should not adopt its plan because the FCC's plan is punitive and inefficient.

During the FairPoint Verizon proceeding (MPUC Docket No. 2007-67), FairPoint offered to increase availability of broadband service.<sup>5</sup> We investigated the FairPoint plan, studying the costs of providing enhanced services and the types of investments required. The FairPoint plan started with the areas that were least expensive to upgrade, and then gradually worked its way up to more expensive investments. Similar to the FCC plan, FairPoint was trying to provide the greatest increase in service for the least cost. Thus, the cost per-unit of increasing availability from 65 to 70 percent is much lower than the cost per-unit of increasing broadband availability from 80 to 85 percent. After the FairPoint-to-Verizon acquisition was completed, FairPoint went into a Chapter 11 re-organization. As part of a settlement, FairPoint committed to increasing its broadband availability to 87%, and it has since achieved an 83% level of broadband deployment.

Now the FCC proposes to introduce a plan to award funding to low per-unit bidders. Because FairPoint has fulfilled much of its commitments, FairPoint no longer is able to submit bids for low cost projects. This inability is not associated with inefficiencies. It is the result of positive actions by FairPoint in fulfilling a need for deployment that the other carrier, Verizon, had ignored. Thus, the auction process proposed by the FCC will punish carriers, such as FairPoint, who provided customers with enhanced services. At the same time, it would reward carriers that have done little or nothing to provide enhanced services -- because the carriers that deployed only low levels of broadband will be able to bid lower and as a result, win the free money from the FCC.

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<sup>5</sup> OPA's testimony recommended that FairPoint reach a higher broadband availability level than FairPoint had proposed.



Moreover, the FCC's proposal is inefficient because it will not cause carriers to bid at cost. Instead it allows bidders to overstate their cost because the low-cost bidders know that other carriers -- i.e., those that have already completed substantial levels of build-out -- no longer have low-cost projects available to bid. Hence, the low-cost bidders will be able to mark-up their costs to amounts that they perceive will slightly underbid the other carriers. In short, the result of the FCC's proposed bidding process will be that carriers that have done nothing will be rewarded twice. First, they will obtain free money and second, that money will not only pay for the cost of the project but will also provide extra cash to enhance their profits -- even though they have been the carriers that had refused to invest their own money in broadband deployment. There are two ways to correct the auction process -- so as to eliminate its unfairness and its inefficiencies. First, carriers with levels of broadband availability below 80 percent might be prohibited from bidding. While this alternative will correct the problems associated with the FCC proposal, it will also punish the customers of the carriers that have refused to invest their own money. Therefore, we do not support this first option. Instead, the FCC could establish tranches dependent on the carriers' current percentage of broadband availability. That is, carriers with 80 to 90 percentage availability will bid against each other and will not bid against carriers with availabilities of less than 80 percent or greater than 90 percent. Each tranche will be allocated the same funding. This scheme will provide funding for carriers that have fulfilled their commitments to provide enhanced services, and to those that have not. Thus, it will be fair to all bidders. It will also require carriers to bid at cost because they will be bidding against carriers that are in similar situations. If the FCC adopts an auction system, we urge the FCC to implement a tranche mechanism so as to allocate funds fairly and efficiently.

**V. THE NEED TO UNDERSTAND THE RELATIONSHIP BETWEEN INCENTIVES AND CONSTRAINTS REGARDING SWITCH REPLACEMENT.**

The NPRM argues that high per-minute access charges are an impediment to innovation and are slowing the adoption of IP-capable switches. At least one party -- i.e., AT&T -- agrees with that argument. At the same time, the NPRM notes that universal service mechanisms based on rate-of-return regulation promote investment. Hence, it appears that the NPRM sets out two logical arguments that contradict each other. First, carriers with high access charges, who are also the rate-of-return carriers, will not invest in new equipment in order to protect their circuit-switched per-minute revenue flows. Second, the same carriers, who are the carriers that receive LSS based on the size of their rate base, have an incentive to invest in new equipment. Given the logically contradictory arguments, it would be reasonable to collect data in order to test whether one argument or the other explains the behavior of the carriers. However, there is no evidence that the data needed to test those propositions has been collected. Instead, arguments without any foundation in reality are presented as if those arguments were based on actual data.

In addition, the actual investment practices of the rural carriers have not been examined. It may prove that the reason for a supposedly -- but not proven -- lag in adoption of IP-capable switches has nothing to do with circuit-switched per-minute access revenue or rate-of-return regulation. Instead, it may be caused by loan collateral commitments and service lives. That is, when a rural carrier purchases a switch, it borrows money for certain length of time, and the investment is the collateral for the loan. The loan life is usually tied to the depreciation service life of the investment. Therefore, if the switch has a service life of ten years, and is purchased with a loan that must be repaid in ten years, a carrier has no incentive to replace the switch prior to paying back the loan associated with that switch, and also may be not able to secure financing for a new switch as long as the loan for the first switch has not been paid off. In such instances, if

the FCC wishes to accelerate the replacement of circuit-based switches by IP-capable switches, the FCC should authorize the amortization of the circuit switches over a short period of time (perhaps five years) and provide a mechanism to that allows carriers to recover that amortization. Such a mechanism might be a surcharge on all intercarrier compensation rates.

## **VI. THE NEED TO COLLECT INFORMATION REQUIRED FOR THE MAINTAINANCE AND PROVISION OF UNIVERSAL SERVICE.**

In order to administer its universal mechanisms properly, the FCC needs to collect a substantial body of information regarding carrier cost and revenue. Because the FCC has recently reduced the data collection requirements for the large carriers, it no longer receives the data needed to monitor whether its mandates are being fulfilled. With regard to the small rural carriers, the FCC has only recently begun to release limited amounts of the data held by NECA regarding LSS, and has recently acquired NECA carrier-specific data on access-charge revenue and minutes. As far as we can tell, there still is no carrier-specific data available to the FCC in the public domain regarding the ICLS revenue and cost. Additional data is needed to implement the state members' plan such as revenue and investment data. We urge the FCC to require any carrier that receives universal service funding to provide the data needed to implement the state members' plan. The data are necessary because that data will allow the FCC to understand whether support is too high or too low -- even if the FCC does not adopt the state members' plan.

On the other hand, Verizon claims that it can no longer verify the jurisdictional nature of traffic -- due to alleged customer practices. Pointing to this inability to verify traffic, Verizon asserts that the Commission must eliminate the differences between interstate and intrastate access rates. At the same time that Verizon asserts that it cannot identify the jurisdictional nature of traffic, the FCC's Telecommunications Industry Revenue Report, -- at Table 6, Row 423, net universal service base revenue -- reports that 73 percent of the wireless revenue is intrastate, 25

percent of the revenue is interstate and 1 percent of the revenue is international. In other words, the wireless industry is reporting interstate universal service contribution base revenue that appears to be far below the interstate 37.1 percent wireless “safe harbor.” A wireless carrier could report a percentage of interstate revenue that is below the safe harbor. However, in such instances, the wireless carrier must be able to document its interstate percentage.<sup>6</sup> Therefore, it appears that, in some situations, carriers can identify the jurisdictional nature of the traffic. If they can identify the traffic for the purposes of contributing to the universal service fund, then it is not credible when the same carriers claim that they cannot identify traffic for the purposes of assigning access minutes to proper rate categories.

## **VII. THE NEED TO MAINTAIN CARRIER-OF-LAST-RESORT OBLIGATIONS AND TERMINATE THE “PARENT-TRAP” RULE.**

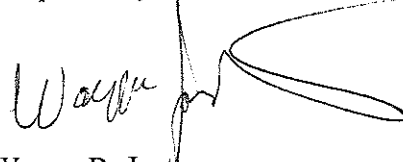
Carrier-of-last-resort obligations commit designated carriers to perform certain duties that are not required of other carriers. These obligations have been offset by certain benefits associated with their legacy positions -- such as the use of rights-of-way, and embedded investments in sunk infrastructure including poles and conduits and first-mover customer relationships. Today, the designated carriers no longer have a monopoly franchise. Therefore, the benefits associated with being a carrier of last resort have been diminished. Some carriers are now proposing that they no longer be held responsible for carrier-of-last-resort obligations. However, given the large numbers of customers (especially in rural areas) who continue to rely on carriers of last resort, it is profoundly premature to consider the elimination of COLR obligations. Instead, we recommend that the Commission make it easier to transfer the COLR obligation by eliminating the portion of §54.301 of its rules that freezes support levels associated with the transfer of exchanges if and only if the exchange is sold at net book value. If those rules

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<sup>6</sup> In the Matter of Universal Contribution Methodology, WC Docket No. 06-122, Report and Order and Notice of Proposed Rulemaking, FCC 06-94, released June 27, 2006.

were eliminated, the purchaser of the exchange would be able to obtain additional universal service funding for providing broadband services in the transferred exchange and the purchaser would be able to fund additional investments because the exchange purchase price would not result in the freezing of universal service support. In addition, the elimination of the “parent-trap” rule would allow for a more efficient merger and acquisition market because, under current rules, non-rural carriers serving substantial numbers of customers in rural areas, are poor prospects for acquisition based on the high costs of serving rural customers.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Wayne R. Jortner", with a large, sweeping flourish extending to the right.

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